Supreme Court, U.S.
FILED
JUL 27 1998
OFFICE OF THE CLERK

No. 97-2045

IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

SOUTH CENTRAL BELL TELEPHONE COMPANY, *et al.*,
Petitioners,

v.

STATE OF ALABAMA AND
STATE DEPARTMENT OF REVENUE,
Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of Alabama

REPLY BRIEF FOR PETITIONERS

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WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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REPLY BRIEF FOR PETITIONERS

The Brief in Opposition underscores the case for certiorari. It confirms that, despite this Court's decision in *Richards v. Jefferson County*, 517 U.S. 793 (1996), Alabama will invoke its aberrant view of res judicata to bar *any* challenge to the State's foreign franchise tax; that Alabama will continue to impose and collect the tax without regard to this Court's controlling Commerce Clause decisions; and that Alabama is already gearing up to erect the next meritless roadblock to taxpayer actions seeking to enforce plainly applicable federal constitutional rights. The Brief in Opposition thus demonstrates that, unless this Court intervenes, Alabama will persist in flouting this Court's authority.

I. RESPONDENTS' THEORY OF RES JUDICATA CONFLICTS WITH FUNDAMENTAL PRINCIPLES OF DUE PROCESS.

Respondents' Brief in Opposition expressly corroborates the startlingly broad proposition implicit in the Alabama Supreme Court's decision: under Alabama res judicata law, *any* person—even one who is "not party (or privy) to [prior] litigation"—can be bound by a judgment if a court determines that the person's "interests were represented adequately by [a] party." Br. in Opp. 6. Under respondents' approach, "adequate representation" has nothing to do with the basic components of due process. One's interests may be held "adequately represented"—and one's ability to pursue an independent claim may therefore be denied—even if one received no notice of the prior litigation, had no opportunity to be heard, and had no connection whatsoever with the case or the parties.

Asserting that this novel principle is nonetheless compatible with the Due Process Clause of the Fourteenth Amendment, respondents rely on a single sentence lifted from *Martin v. Wilks*, 490 U.S. 755, 762 n.2 (1989), in which this Court said that a nonparty may sometimes be bound by the outcome of prior litigation where "its interests [were] adequately represented by someone with the same interests who is a party." *See* Br. in Opp. 6. But far from creating a general due-process exception based on "adequate representation," the Court in *Martin* expressly confined its pronouncement to "certain limited circumstances." 490 U.S. at 762 n.2. The Court noted only two instances in which the principle applies: cases involving " 'class' or 'representative' suits," and cases in which the nonparty exercised "control" over the prosecution of the prior suit. *Id.* (citing *Hansberry v. Lee*, 311 U.S. 32, 41-42 (1940), and *Montana v. United States*, 440 U.S. 147, 154-55 (1979)). This case fits neither category.

Respondents assert that "the taxpayers in *Reynolds* . . . can be said to be members of the same class as the taxpayers in this case." Br. in Opp. 7. They do not contend, of course, that *Reynolds* was a class or representative suit in any traditional sense—it plainly was not. Instead, under respondents' theory, petitioners are bound by *Reynolds* merely because their "interests with respect to the Alabama franchise tax parallel" those of the *Reynolds* plaintiffs, and because the *Reynolds* plaintiffs were "represented . . . by some of the top law firms in the State of Alabama, which rendered to them more than competent representation." *Id.* at 8.

But this Court made clear in *Richards* that binding a nonparty on the strength of nothing more than representation of *that* kind is utterly incompatible with due process. In *Richards*, a group of taxpayers sued to invalidate an unconstitutional tax that had been sustained in a prior lawsuit (the *Bedingfield* litigation) brought by other taxpayers, a city, and a city official. The Alabama Supreme Court in *Richards* had held that *Bedingfield* could be used as a res judicata bar for the same reason that respondents propose here: the taxpayer plaintiffs in the prior suit had " 'adequately represented the interests' " of the taxpayer plaintiffs in the later action. 517 U.S. at 801 (quoting the Alabama Supreme Court's opinion). This Court flatly rejected this "adequate representation" theory. It stated, in terms that apply with equal force here, that the first set of taxpayers "did not sue on behalf of a class," that "their pleadings did not purport to assert any claim against or on behalf of any nonparties," and that "the judgment they received did not purport to bind any county taxpayers who were nonparties." *Id.*[1] *Richards* thus rejected the very theory on which respondents now rely.

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[1] *See also* 517 U.S. at 802 ("Nor is there any reason to suppose that the individual taxpayers in *Bedingfield* understood their suit to be on behalf of absent county taxpayers. Thus, to contend that the plaintiffs in *Bedingfield* somehow represented petitioners, let alone represented them in a constitutionally adequate manner, would be to attribute to them a power that it cannot be said that they had assumed to exercise.") (internal quotation marks omitted).

Respondents try to neutralize *Richards* by altering the facts of that case. Implying that the *Bedingfield* plaintiffs included only "Birmingham's acting finance director and the city," respondents argue that those plaintiffs simply "did not adequately represent" the taxpayer plaintiffs in *Richards* because they were not members of the same "class." Br. in Opp. 7. But even a casual reading of this Court's opinion in *Richards* shows that the *Bedingfield* plaintiffs *did* include taxpayers—indeed, taxpayers with interests " 'essentially identical' " to those of the *Richards* plaintiffs—and that the Court expressly rejected a res judicata theory based on "adequate representation" by those taxpayer plaintiffs. *See* 517 U.S. at 795, 796, 801. It is troubling that respondents would so fundamentally misstate this Court's decision in *Richards*—a case that originated in Alabama and stands on all fours with the present case.[2]

Respondents' Brief in Opposition thus brings into sharp focus why this Court should grant the petition in this case. Even though Alabama's foreign franchise tax is clearly at odds with this Court's unambiguous Commerce Clause jurisprudence, respondents continue to assess and collect the tax. Respondents' brief makes crystal clear

[2] Respondents also assert that the petition in this case involves "unique facts," Br. in Opp. 7, but they identify none. They do note that "one of the taxpayers in these cases" asked that its suit be held in abeyance pending a final decision in *Reynolds*. *Id.* at 8. But because the Alabama courts held that the remaining petitioners —who did *not* request abeyance—were equally barred, the abeyance request is inconsequential. *See* Pet. 22. In any event, abeyance requests simply have no place in the due-process equation. *See* Pet. 22-23. Nor can it possibly matter that "taxpayers filed petitions for refund with the Department [of Revenue] during the pendency of the *Reynolds* case." Br. in Opp. 8. State taxpayers routinely file refund claims to preserve their constitutional rights, and the timing of such claims often is dictated by state statutes of limitations. A taxpayer's compliance with such state-imposed refund procedures can hardly be used as a basis for invoking res judicata to strip the taxpayer of its right to pursue its federal constitutional claim in court.

that they intend to continue doing so for as long as they can get away with it. And there is no reason to doubt that Alabama courts will follow respondents' lead in saying that *Reynolds* should bar lawsuits brought by *any* "foreign corporatio[n] doing business in Alabama subject to the Alabama franchise tax." Br. in Opp. 8. Accordingly, postponing review will accomplish nothing. The Court should act now to halt Alabama's unlawful disdain of the Supremacy Clause and defiance of this Court's authority.

II. ALABAMA'S TAX PLAINLY VIOLATES THE COMMERCE CLAUSE.

Respondents' Commerce Clause arguments are equally meritless. *First*, respondents seek to remove Alabama's tax from the "virtually per se rule of invalidity" applicable to facially discriminatory taxes. Br. in Opp. 9. According to respondents, "[b]ecause the measure of the two taxes admittedly has different rates and bases, it cannot be determined from reading them whether any discrimination exists." *Id.* But this misses the essential nature of the discrimination that is apparent on the face of the statute. Alabama law permits domestic corporations to pay a tax on a base of their own choosing,[3] while compelling foreign corporations to pay tax on a base determined by their business activities in the State. *See* Pet. 4-5. A tax, whatever its rate or base, always favors those who are free to determine their own tax liability over those who

[3] Relying on the testimony of Richard G. Bacon, respondents suggest that "business reasons" may limit the ability of domestic corporations to manipulate the tax base. Br. in Opp. 12 (citing Tr. 125-162 but apparently meaning Tr. 125-126). But Mr. Bacon testified about the ability of corporations to manipulate their tax base for purposes of *Delaware* law by limiting the number of shares they have outstanding. *See* Tr. 114, 125-26. Mr. Bacon did not testify concerning corporations' ability to manipulate their tax base for purposes of Alabama law by the costless expedient of reducing the par value of their stock. *See* Pet. 4; Stipulated Facts ¶¶ 21-24 (Pet. App. 52a-53a).

are not accorded such discretion. There is therefore no escape from the conclusion of the dissenters below: "the Alabama franchise tax *facially* discriminates against interstate commerce." Pet. App. 12a (emphasis added).[4]

Second, respondents contend that the tax does not discriminate against interstate commerce because, if petitioners were domestic corporations, "their taxes in most instances would have been increased many times over." Br. in Opp. 10. But the trial court rejected this very argument: it determined, as a factual matter, that petitioners "clearly and abundantly demonstrate[d]" that the State's "franchise tax on foreign corporations discriminates against them for no other reason than the state of their incorporation." Pet. App. 21a-22a. Respondents do not explain why they should be permitted to reargue the facts in this Court.

In any event, respondents' argument is meritless. To determine petitioners' "as if domestic" liability, the study on which respondents rely calculated the franchise tax on the basis of petitioners' existing "capital stock (par value)." Br. in Opp., App. at 2 of 7; *see id.* at 6 of 7. A substantial "as if domestic" tax figure resulted because

[4] Respondents suggest that, to the extent the tax is discriminatory, foreign corporations can avoid it "by reducing the capital they employ in Alabama" (Br. in Opp. 12)—*i.e.*, by limiting their business activities within the State. But forcing taxpayers to choose between subjecting themselves to a discriminatory tax or deploying their resources elsewhere to avoid the exaction plainly "forecloses tax-neutral decisions" (*Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 331 (1977)), thereby undermining our national common market. Indeed, this Court has specifically held that a victim's ability to circumvent discrimination by yielding to its illicit incentives cannot save an impermissibly discriminatory tax. *See Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Finance*, 505 U.S. 71, 78 (1992) (there is "no authority for the . . . proposition . . . that a tax that . . . discriminate[s] against foreign commerce may be upheld if a taxpayer could avoid that discrimination by changing the domicile of the corporations through which it conducts its business").

petitioners, not being Alabama corporations, have never had any reason to assign an artificially low par value to their stock. If petitioners had incorporated in Alabama, however, they would obviously have had every reason to minimize the par value of their stock, *see* Tr. 165, 199, 286—just as Alabama corporations typically do, *see* Pet. 4; Tr. 213-14. Respondents' study thus cannot be taken seriously: it inconsistently treats petitioners as if they *are* Alabama corporations, but not as if they *act like* Alabama corporations.

Third, respondents suggest that the discriminatory franchise tax can be saved on the theory that " 'it advances a legitimate local purpose that cannot be adequately served by reasonable, nondiscriminatory alternatives.' " Br. in Opp. 12 (quoting *New Energy Co. v. Limbach*, 486 U.S. 269, 278 (1988)). But that assertion cannot survive even superficial analysis, much less the "strictest scrutiny" to which this Court subjects such claims. *New Energy,* 486 U.S. at 279 (internal quotation marks omitted); *see Fulton Corp. v. Faulkner,* 516 U.S. 325, 345 (1996). The purpose of *every* discriminatory tax can be "adequately served by reasonable, nondiscriminatory alternatives"—namely, a nondiscriminatory tax. *See Chemical Waste Mgmt., Inc. v. Hunt,* 504 U.S. 334, 344-45 (1992). Moreover, the purposes to which respondents point—including an intent to implement a state constitutional provision and a desire to promote administrative convenience (Br. in Opp. 13)—clearly do "not constitute the kind of serious health and safety concern[s] . . . sufficient to justify discriminatory state legislation." *Kraft,* 505 U.S. at 82.[5]

Finally, respondents claim that the complementary tax doctrine has not changed substantially since the *Reynolds*

[5] Respondents' argument appears to be something of an afterthought in any event. At trial, Alabama's Franchise Tax Division Chief testified that he could think of no purpose that might be served by discriminating against foreign corporations. *See* Tr. 201-04.

case, and they assert that this petition is therefore no more certworthy than the petition in *Reynolds*. *See* Br. in Opp. 15. Petitioners have no quarrel with the observation that the essential elements of the Court's complementary tax doctrine were established at the time of *Reynolds*. Indeed, petitioners believe that, if the Alabama Supreme Court in *Reynolds* had properly interpreted this Court's complementary tax cases, it would have invalidated Alabama's foreign franchise tax long ago. But our point is a narrower one: whatever uncertainty may have existed at the time of *Reynolds* about the defensibility of Alabama's discriminatory tax scheme under the complementary tax doctrine, there can be no such doubt now in light of this Court's subsequent decisions in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996); *Associated Indus. of Missouri v. Lohman*, 511 U.S. 641 (1994); and *Oregon Waste Sys., Inc. v. Department of Environmental Quality*, 511 U.S. 93 (1994).[6]

At any rate, respondents present no serious defense of Alabama's franchise tax under the complementary tax doctrine. With respect to the requirement that a tax on interstate commerce "must be shown roughly to approximate—but not exceed—the amount of the tax on intrastate commerce," *Oregon Waste*, 511 U.S. at 103, respondents rest simply on their meritless claim that the tax does not discriminate at all, *see* Br. in Opp. 15. And respondents make no effort to explain how the domestic shares tax can satisfy the "substantially equivalent events" test beyond suggesting that the shares tax is "based on the same measure" as the foreign franchise tax. *Id.* at 16. Nor do respondents offer any response to petitioners' arguments that the domestic shares and foreign franchise taxes

[6] Besides, there are many other reasons that may explain why this Court denied review in *Reynolds*. For example, the Court may have determined that the evidentiary failure found by the Alabama Supreme Court (*see* Pet. 7)—a failure fully rectified in the present case—made *Reynolds* a poor vehicle for addressing the legal issues presented.

are imposed on different events and different taxpayers, and that the domestic shares tax is already "complemented" by the foreign shares tax. *See* Pet. 27-28 & n.15.

III. RESPONDENTS' "PURE PROSPECTIVITY" ARGUMENT IS MERITLESS.

Respondents finally argue that, if this Court rejects the State's res judicata theory and invalidates the foreign franchise tax, it should remand to the Alabama Supreme Court for determination of a remedy. Br. in Opp. 16. At the same time, however, respondents signal their intention, on any such remand, to throw yet another obstacle in petitioners' path: they will argue that a decision in this case invalidating Alabama's foreign franchise tax should be applied purely prospectively, so that not even petitioners themselves would be accorded the benefit of such a decision. *See id.*

Even assuming that there might still be cases in which a decision announcing a rule of federal law may properly be given only prospective effect, this could not possibly be such a case. If either this Court or an Alabama court were to invalidate the State's foreign franchise tax, it would do so because of rules of federal law announced by this Court in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), and other cases that rejected a *de minimis* defense and that narrowly restated the complementary tax doctrine. Because this Court applied those rules to the parties before it in those cases, the Alabama courts on remand may not withhold the benefit of those rules from petitioners. *See Harper v. Virginia Dep't of Taxation*, 509 U.S. 86, 90 (1993) ("this Court's application of a rule of federal law to the parties before the Court requires every court to give retroactive effect to that decision").[7]

[7] Not even respondents take issue with the proposition that petitioners will be entitled, in that event, to refunds in accordance with Alabama's established refund procedures. *See* Pet. 29. This Court's decisions leave no room for any other result. *See Newsweek, Inc.*

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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